

Supplemental Letter of Findings: 04-20130229 & 04-20130230
Use Tax
For the Tax Years 2008, 2009, and 2010

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is suspended by the publication of another document in the Indiana Register.

ISSUE

I. Use Tax-Imposition.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-4-1; IC § 6-2.5-5 et seq.; IC § 6-8.1-5-1; National Geographic Society v. California Board of Equalization, 430 U.S. 551 (1977); Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); [45 IAC 2.2-4-2](#).

Taxpayers protest the Department's determination that tax was properly paid on the purchase of certain laptop computers that were "used outside" of Indiana and on the purchase of "document scanning services."

STATEMENT OF FACTS

Taxpayers, Corp A and Corp B, are affiliates that conduct business in Indiana. Corp A sells medical testing and diagnostic products and services to researchers, physicians, hospitals, laboratories, and wholesalers inside and outside Indiana. Corp B manufactures various products that include medical testing and diagnostic tools, performs the associated research and development for the items, and distributes the items. Taxpayers employ several thousand employees and approximately seventy-eight percent are Indiana employees.

The Indiana Department of Revenue (the "Department") audited Taxpayers' business and tax records for sales and use tax compliance for the tax years 2008, 2009, and 2010. As a result of the audits, the Department assessed Taxpayers additional use tax and interest for those periods. Due to the large volume of Taxpayers' invoices, the Department assessed Taxpayers additional use tax based on a statistical sampling of their invoices. The statistical sample included both expenses and assets. Taxpayers provided SAP ("System Applications Products") data files for the years at issue. The accounts that were used in the sample were agreed to by the Department's auditor and Taxpayers. It was agreed also to combine the records into a single file resulting in one sample. The sample invoices were categorized into seven different strata based on dollar amounts. Each purchase was reviewed and a determination was made whether to make an adjustment. The taxable purchases in each stratum were applied to the total of the sample purchases for that stratum in order to arrive at an error percentage for each stratum. Each stratum's error rate was applied to the stratum base amounts to arrive at additional taxable purchases for each stratum. The results were allocated based on Corp A's and Corp B's purchasing activity for each stratum. The total of additional taxable purchases for all strata was used as the numerator and the total for all the strata base amounts was used as the denominator. The resulting percentage was used as the error percentage to be applied to the totals for each year. Stratum 7 purchases were reviewed in detail. Since a detailed review was performed, the taxable purchases in that stratum for each company were assigned on an actual basis. It should be noted that credit card transactions were not included in this statistical review. A separate sample was used to review the credit card transactions. The review of the statistical sample invoices for expenses and assets for strata one through seven, revealed fourteen areas of noncompliance.

Taxpayers jointly protested a portion of their assessments on the same issues raising issues relating to a few of these areas of noncompliance. An administrative hearing was held on Taxpayers' protest, and the Department issued a Letter of Findings (04-20130229; 04-20130230) (the "Letter of Findings") on March 10, 2014, denying their protest. Taxpayers requested a rehearing, which the Department granted. A rehearing was held, and this Supplemental Letter of Findings results. Additional facts will be presented as needed.

I. Use Tax-Imposition.

DISCUSSION

For purposes of this Supplemental Letter of Findings ("Supplemental"), the Letter of Findings is incorporated by reference. This Supplemental will refer only to the issues raised on rehearing.

As a threshold issue, the notice of proposed assessment is prima facie evidence that the Department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made. IC § 6-8.1-5-1(c); *Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); *Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012).

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b). Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). In general, all purchases of tangible personal property are subject to sales and/or use tax. An exemption from use tax is granted for transactions where sales tax was paid at the time of the purchase pursuant to IC § 6-2.5-3-4. In certain circumstances, additional enumerated exemptions from sales and/or use tax are available. IC § 6-2.5-5 et seq.

During the audit, the Department performed a statistical sampling of Taxpayers' invoices. In the line items examined, the Department found that Taxpayers had made purchases of tangible personal property without paying sales tax at the time of the purchases, and, therefore, made an assessment of use tax. The Department's audit assessed Taxpayers additional use tax based on the results of the statistical sampling of Taxpayers' invoices. Taxpayers protest the Department's assessment. Taxpayers maintain that the Department's statistical sampling error rate was incorrectly calculated based upon the Department's determination that tax was properly paid on the purchase of certain laptop computers that were "used outside" of Indiana and on the purchase of "document scanning services."

A. "Property Used Outside Indiana."

Taxpayers protest that the Department's audit did not properly provide credit to Taxpayers in the Department's statistical sample. Taxpayers maintain that Taxpayers should have received credit on items upon which Taxpayers had already paid the tax that were similar to those items that the Department found were not subject to Indiana use tax. Taxpayers assert that they should receive a "refund" in the form of a "credit" in the sample projection of the audit for the portion of the tax that they paid that relates to "out-of-state usage"/"temporary storage" for these similar purchases.

Indiana recognizes an exception from the imposition of use tax that is generally referred to as the "temporary storage" exception. As stated previously, the Indiana use tax is imposed on the "storage, use or consumption of tangible personal property in Indiana." IC § 6-2.5-3-2(a). "'Storage' [is defined as] the keeping or retention of tangible personal property in Indiana for any purpose except the subsequent use of that property solely outside Indiana." IC § 6-2.5-3-1(b). Additionally, IC § 6-2.5-3-2(e)(3) provides that the Indiana "use tax is not imposed on the keeping, retaining, or exercising of any right or power over tangible personal property if . . . the property is subsequently transported out of state for use solely outside Indiana." These statutes read together provide the "temporary storage" exception to the imposition of the Indiana use tax. Based on application of the "temporary storage" exception, the Department's audit found that a number of the software licenses, promotional materials, and computers that were purchased outside of Indiana, were temporarily stored in Indiana, and were then shipped and used solely outside of Indiana would not be subject to Indiana use tax. Therefore, in deriving the statistical sample error rate percentage, the Department's audit did not impose the use tax on certain of the Taxpayers software, promotional materials, and computer purchases that met the "temporary storage exception."

Taxpayers submitted additional documentation with their original protest. This additional documentation indicated to the Department that Taxpayers were only requesting credit for items where sales tax was paid at the time of transaction for a specific list of transactions. The Letter of Findings stated that the invoices presented in the original protest demonstrated that Corp A and Corp B correctly paid sales tax to the respective vendors at the time of purchase for the Indiana retail transactions. Since the vendors properly collected sales tax from Taxpayers on the retail transactions that occurred in Indiana, the Department correctly did not provide any credit to Taxpayers for a portion of the sales tax paid on items that were purchased in Indiana retail transactions. Thus, the Letter of Findings denied Taxpayers' protest on this issue.

The Letter of Findings explained that the "temporary storage exception" only applies to Indiana's imposition of its use tax and that the Indiana sales tax does not contemplate a "temporary storage" exception. Indiana sales tax is a transaction tax that is imposed on the occurrence of an Indiana retail sales transaction. IC § 6-2.5-2-1(a). The purchaser in the retail transaction is liable for the sales tax and must pay the sales tax to the retail merchant. IC § 6-2.5-2-1(b). A retail transaction is defined as "a transaction of a retail merchant that constitutes selling at retail as described in IC § 6-2.5-4-1 . . . or that is described in any other section of IC § 6-2.5-4." IC § 6-2.5-1-2. "A person is a retail merchant making a retail transaction when he engages in selling at retail." IC § 6-2.5-4-1(a). IC § 6-2.5-4-1(b) explains that a person sells at retail when he "(1) acquires tangible personal property for the purpose of resale; and (2) transfers that property to another person for consideration." When a retail merchant has sales tax nexus with a state, anytime that retail merchant enters into a retail transaction that is completed in that state—i.e., the tangible personal property is either accepted or delivered into that state—the retail merchant has an obligation to collect and remit sales tax on the retail transactions. IC § 6-2.5-2-1; IC § 6-2.5-13-1; IC § 6-2.5-9-3; See also *National Geographic Society v. California Board of Equalization*, 430 U.S. 551, 560-61 (1977) (explaining that nexus is established between the overall relationship that the seller has with the taxing state, is unaffected by the relationship of a specific activity of the seller, and once established creates an obligation to collect and remit sales tax to the state on every transaction within the state).

On the other hand, the use tax is a tax imposed on a purchaser for the purchaser's use of the property in Indiana pursuant to IC § 6-2.5-3-2(a). As explained previously, the "temporary storage exception" is an exception to the imposition of the use tax based upon the taxpayer's using property in Indiana in a way which fails to meet the statutory definitions of storage or use for imposition of the Indiana use tax. IC § 6-2.5-3-1; IC § 6-2.5-3-2. Since the sales tax is a tax imposed on the purchaser based solely on the occurrence of a retail transaction and does not contemplate the taxpayer's use of the property, the "temporary storage exception"—which is based upon a taxpayer's use of property—only applies to the Indiana use tax transactions and does not apply to the Indiana sales tax transactions.

Taxpayers requested a rehearing and narrowed their protest on this issue to Taxpayers' purchase of specific laptop computers. Taxpayers assert that they did not receive an "out of state use" credit in the audit's statistical sample for certain laptop computers where Taxpayers had improperly paid use tax. Taxpayers maintain that some of the laptops purchased qualify for the "temporary storage exception" from use tax.

During the rehearing process, Taxpayers presented documentation to demonstrate that the transactions with a specific Michigan vendor for a large number of "HP Notebook" laptop computers were not transactions that were subject to sales tax as first presented but were actually transactions that were subject to use tax. Specifically, Taxpayers presented a spreadsheet which detailed the location of the purchase transactions with the Michigan vendor for the "HP Notebook" laptop computers within the Department's audit's statistical sample. Taxpayers presented the invoices where Taxpayers purchased the "HP Notebook" laptop computers from the Michigan vendor. These invoices indicated that the laptop computers were delivered into Indiana by the United Parcel Service. The Michigan vendor's invoices reflected that no tax was paid at the time of the transactions. The Michigan vendor's website provided that all of its business operations took place in Michigan. The Michigan vendor is not registered with the Indiana Secretary of State to do business in Indiana. Information otherwise available to the Department demonstrated that the Michigan vendor did not have sales tax nexus with Indiana. Taxpayers did not present sales tax exemption certificates to the Michigan vendor. Taxpayers' records demonstrated that Taxpayers, in their monthly filing, self remitted use tax to the Department on all of the laptop computers in the invoices. Taxpayers explained that a number of these laptop computers were only temporarily in Indiana before being sent to their employees that were located outside of Indiana. Taxpayers stated that they incorrectly paid use tax for one hundred percent of the laptop computers instead for those laptop computers that remained in Indiana.

Based on the documentation provided, Taxpayers purchased a large number of "HP Notebook" laptop computers from a Michigan vendor that were not subject to sales tax, but would be subject to use tax if used or stored in Indiana. Taxpayers may have paid use tax for laptop computers that were only temporarily in Indiana and were sent to employees outside of Indiana. The Department did not give any credit in the audit's statistical sample for the laptops from the Michigan vendor transactions that met these conditions. The audit division is requested to review the additional documentation provided by Taxpayers for the laptop computers purchased from the Michigan vendor and make any necessary adjustments.

Accordingly, Taxpayers' protest to the imposition of use tax, based upon the Department's determination not to provide credit for use tax paid for certain laptop computers, is sustained in part subject to the results of the supplement audit.

B. "Document Scanning Services."

Taxpayers assert that the Department's audit did not properly credit Taxpayers for a line item on one of Corp B's invoices in the audit's statistical sample. The Department included in the statistical sample a line item from an invoice for Corp B from Document Management Solutions (invoice number 24025, stratum 3, sort 79). According to Taxpayers, this invoice contains a line item for "document scanning" which Taxpayers state is strictly a "service" and therefore should not be subject to sales or use tax. Taxpayers assert that they were incorrectly charged sales tax on this line item that relates to a "non-taxable service charge." Taxpayers maintain that they should receive a "refund" in the form of a "credit" in the audit for the portion of the sales tax that they paid for this "service charge."

Taxpayers argue that the "document scanning" line item is a "non-taxable service charge" pursuant to [45 IAC 2.2-4-2\(a\)](#). The regulation to which Taxpayers cites, [45 IAC 2.2-4-2\(a\)](#), generally states that services with respect to property not owned by the person rendering the service are not considered transactions of a retail merchant constituting selling at retail and are therefore not subject to tax. However, [45 IAC 2.2-4-2\(a\)](#) does clarify that if a serviceperson in performance of a service also transfers tangible personal property for consideration, that transaction is a transaction of a retail merchant selling at retail and therefore potentially subject to tax unless certain conditions are met. A service provider will not be deemed a retail merchant when the following conditions are met: (1) "the service [provider] is in an occupation that primarily [provides services];" (2) "the tangible personal property purchased is used or consumed as a necessary incident to the service;" (3) "the price charged for the tangible personal property is inconsequential"-meaning that it is less than ten percent of the service charge; and (4) the service provider paid sales tax when it purchased the tangible personal property or remitted use tax on the purchase of the tangible personal property that was transferred. [45 IAC 2.2-4-2\(a\), \(d\)](#).

During the rehearing, Taxpayers presented a copy of the Document Management Solutions invoice containing the "documenting scanning" line item that was selected in the audit sample. Taxpayers maintain that the invoice represents charges that Taxpayers paid for Document Management Solutions to scan Taxpayers' documents that Taxpayers provided to Document Management Solutions which were put on a compact disc. The invoice demonstrates that Taxpayers were charged a \$749.80 for "document scanning" and \$25 for the compact disc. The invoice also demonstrates that sales tax was charged on the "document scanning" charge as well as the charge for the compact disc.

The documentation provided demonstrates that the documents that were scanned by Document Management Solutions were provided by Taxpayers, the charge for the compact disc and "document scanning services" were separately stated, the charge for the compact disc was less than ten percent of the service charge, and tax was charge on the compact disc transferred. Therefore, based upon the documentation provided, the charge on this invoice for the "document scanning" services meets the service provider exception illustrated in [45 IAC 2.2-4-2](#). Therefore, based upon the documentation provided, Taxpayers have demonstrated that the "document scanning" charge is not subject to sales tax and tax was improperly paid to the vendor.

Accordingly, Taxpayers' protest to the imposition of use tax based upon the Department's determination not to provide credit for sales tax paid for "document scanning services" is sustained. Taxpayers' file will be returned to the audit division for a supplemental audit where the audit division will make the necessary adjustments.

FINDING

Taxpayers' protest to the imposition of use tax, based upon the Department's determination not to provide credit for use tax paid for certain laptop computers, is sustained in part subject to the results of the supplement audit, as discussed in subpart A. Taxpayers' protest to the imposition of use tax, based upon the Department's determination not to provide credit for sales tax paid for "document scanning services," is sustained, as discussed in subpart B.

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